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No. 80-1251

In the Supreme Court of the United States

OCTOBER TERM, 1980

UNITED STATES OF AMERICA, PETITIONER

v.

VOGEL FERTILIZER COMPANY

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

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QUESTION PRESENTED

Section 1561(a) of the Internal Revenue Code of 1954 (26 U.S.C.) provides that a "controlled group of corporations" shall be limited to a single corporate surtax exemption. Under Section 1563(a)(2), a "controlled group of corporations" includes a "brother-sister group," which is defined in part as "[t]wo or more corporations if 5 or fewer persons who are individuals * * * own * * * stock" possessing 80% of the total combined voting power of all classes of voting stock or of the total value of all classes of the stock of each corporation.

The question presented is whether the statutory definition is met if the "5 or fewer persons" own the prescribed 80% of the stock singly or in combination, as the governing Treasury Regulations provide, or whether each person whose stock is to be taken into account must own stock in each corporation of the group, as the decision below held.

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OPINION BELOW

The opinion of the Court of Claims (Pet. App. 1a-42a) is reported at 634 F.2d 497.

JURISDICTION

The opinion of the Court of Claims was filed on August 13, 1980. The order denying rehearing en banc was entered on October 3, 1980 (Pet. App. 43a). The judgment of the Court of Claims was entered on November 28, 1980 (Pet. App. 44a). The petition for a writ of certiorari was filed on January 23, 1981, and was granted on March 23, 1981. The jurisdiction of this Court rests on 28 U.S.C. 1255.

STATUTE AND REGULATIONS

The relevant provisions of Section 11(d), 1561(a) and 1563(a)(2) of the Internal Revenue Code of 1954 (26 U.S.C.), and of Treasury Regulations, Section 1.1563-1(a)(3) (26 C.F.R.), are set forth at Appendix, *infra*, 1a-4a.

STATEMENT

1. Respondent Vogel Fertilizer Company is an Iowa corporation in the business of selling farm fertilizer products at retail to local customers. During 1973-1975, respondent had only common stock issued and outstanding, which was owned by Arthur Vogel (113,575 shares—77.49%) and Richard Crain (33,000 shares—22.51%) (Pet. App. 2a).

Vogel Popcorn Company is a separate corporation engaged in a business unrelated to that of respondent. During 1973-1975, Vogel Popcorn had issued and outstanding 440,602 shares of common stock, all of which was owned by Arthur Vogel, and 62,866 shares of voting preferred stock, all of which was held by Arthur Vogel as trustee of the Alex Vogel Family Trust. As a result, Arthur Vogel owned 87.5% of all classes of Vogel Popcorn stock entitled to vote. The Alex Vogel Trust in turn owned 12.5% of such stock (Pet. App. 2a).

In its corporate income tax returns for the taxable years 1973-1975, respondent originally treated itself and Vogel Popcorn as members of a brother-sister controlled group of corporations as defined by Section 1563(a)(2). This position was in accord with the governing Treasury Regulation (Section 1.1563-1(a)(3)), which generally provides that the term "'brother-sister controlled group'" means "two or more corporations if the same five or fewer persons

* * * own * * * *singly or in combination*, stock possessing—(a) [a]t least 80 percent of the total combined voting power of all classes of stock * * * of each corporation; and (b) [m]ore than 50 percent of the total combined voting power of all classes of stock * * * of each corporation, taking into account the stock ownership of each such person only to the extent such stock ownership is identical with respect to each such corporation" (emphasis added) (Pet. App. 2a, 4a-5a).

Because respondent treated itself as a member of a controlled group of corporations, it did not claim the full corporate surtax exemption provided by Section 11(d) of the Internal Revenue Code of 1954. For its taxable years ended November 30, 1973 and 1974, respondent elected to utilize the multiple surtax exemption under Sections 1562 and 1564(a) and to pay the multiple surtax penalty imposed by Section 1562(b). For the taxable year ended November 30, 1975, respondent elected under Section 1561(a)(2) to allocate the single surtax exemption then allowed to members of a controlled group of corporations entirely to Vogel Popcorn (Pet. App. 3a).

Respondent thereafter filed timely claims for refund for each of the years in question. In those claims, respondent disavowed the position taken on its returns that it and Vogel Popcorn were members of a controlled group of corporations. Respondent now argued that it and Vogel Popcorn were not so related and that therefore it was entitled to a full surtax exemption for each taxable year. After the Internal Revenue Service disallowed respondent's claims on the authority of the governing Treasury Regulations, respondent commenced this refund suit in the United States Court of Claims (Pet. App. 3a).

2. A divided panel of the Court of Claims upheld respondent's position that it was entitled to a separate surtax exemption (Pet. App. 1a-36a). It first pointed out that the dispute between the parties involved only the 80% test of Section 1563(a)(2)(A). Specifically, the question presented was whether Richard Crain, who held no stock in Vogel Popcorn, could be counted as one of the group of "five or fewer persons" who held 80% of the stock of each corporation. In arguing that Richard Crain could not be so counted, respondent conceded that the Treasury Regulations (Section 1.1563-1(a)(3)(ii)) explicitly provided that "five or fewer persons" can own 80% of the stock of both corporations, singly or in combination, and included an example corresponding exactly to the facts of this case (Pet. App. 6a).

After acknowledging that three circuits had upheld the validity of the Regulation which was the basis of the government's position,[1] the Court of Claims struck down the Regulation and instead approved "the statutory construction made by the Tax Court in *Fairfax Auto Parts of Northern Virginia, Inc.* v. *Commissioner*, * * * 65 T.C. [798] at 802-803 [(1976, rev'd, 548 F.2d 501 (4th Cir.), cert. denied, 434 U.S. 904 (1977) as] the most careful and best analysis of the statute to date" (Pet. App. 8a; footnote omitted). In the Court of Claims' view, the statutory term "each such person" in the 50% test of Section 1563(a)(2)(B) modified the earlier phrase

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[1] *Fairfax Auto Parts of Northern Virginia, Inc.* v. *Commissioner*, 65 T.C. 798 (1976), rev'd, 548 F.2d 501 (4th Cir.), cert. denied, 434 U.S. 904 (1977); *Allen Oil Co.* v. *Commissioner*, 614 F.2d 336 (2d Cir. 1980); *T. L. Hunt, Inc.* v. *Commissioner*, 562 F.2d 532 (8th Cir. 1977).

in subsection (2)—"5 or fewer persons". As a result, the court concluded that for a person's stock ownership to be taken into account for purposes of the 80% test of Section 1563(a)(2)(A), that person must own stock in each member of the brother-sister controlled group (Pet. App. 10a).

In so holding, the Court of Claims "admitted that the different view taken by Treas. Reg. § 1.1563-1(a)(3) * * * [that the "5 or fewer persons" could own the prescribed percentages of stock singly or in combination] [is] not wholly unreasonable as a construction of the words appearing in section 1563(a)(2)" (Pet. App. 12a). However, the court ruled that the Regulation is "clearly inconsistent with the legislative history and unreasonable when the purpose, as well as the bare words, of the statute are considered" (Pet. App. 12a).

3. The dissenting judge would have upheld the validity of the Regulation (Pet. App. 36a-42a). As he saw the matter, "the issue is not whether [respondent's] interpretation is *as* reasonable as [the government's]; clearly that will be true in certain given factual situations. The issue is whether [respondent] has carried its heavy burden of showing the regulation to be unreasonable and plainly inconsistent with the statute. This [respondent] cannot do or at least has not done" (emphasis in original) (Pet. App. 38a).

The dissent noted that if Richard Crain owned but a single share of stock in Vogel Popcorn, then the two corporations would have constituted a brother-sister group even under the majority's interpretation (Pet. App. 41a). Absent any proof "that Congress intended the mechanical test which the ma-

jority had in mind and which leads to the unreasonable results just described" (Pet. App. 42a), the dissent would have disallowed respondent's claim on the authority of the Regulation.

SUMMARY OF ARGUMENT

1. In holding that respondent and Vogel Popcorn were not members of a "brother-sister" controlled group of corporations within the meaning of Section 1563(a) of the Internal Revenue Code of 1954 because the same persons were not shareholders in both corporations, the Court of Claims' decision is at odds with the plain language and structure of the statute, its legislative history, and the governing Treasury Regulations.

Section 1561(a) of the Code provides that a "controlled group of corporations" shall be limited to a single corporate surtax exemption. In enacting the statute, Congress sought to provide an objective mathematical test to eliminate income splitting among corporations operated as one economic entity. Under Section 1563(a)(2), a controlled group includes a "brother-sister group," which consists of "[t]wo or more corporations if 5 or fewer persons who are individuals * * * own * * * stock" possessing—

> (A) at least 80 percent of the * * * stock of each corporation, and
>
> (B) more than 50 percent of the * * * stock of each corporation, *taking into account the stock ownership of each such person only to the extent such stock ownership is identical with respect to each such corporation.* [Emphasis added.]

Under the statute, subparagraphs (A) and (B) set forth an 80% test and a 50% test. The only substantive difference between the two tests is the italicized language of subparagraph (B), which introduces a limitation not applicable to the 80% test. Thus, the stock owned by any or all of the five persons may be taken into account in determining whether the 80% test has been met. On the other hand, in determining whether the 50% test has been satisfied, it is necessary to ascertain which of such persons owns stock in both of the corporations and how much each of them owns. Only to the extent that a person owns stock in each of the corporations is his stock taken into account for purposes of the 50% test. Accordingly, a person who owned no stock in one of the corporations would be excluded from consideration for purposes of that test. That is the import of the italicized language of subparagraph (B)—"taking into account the stock ownership of each such person only to the extent such stock ownership is identical with respect to each such corporation."

Applying the statute to the facts of the instant case, Arthur Vogel owned 77.49% of the voting stock of respondent Vogel Fertilizer and 87.5% of the voting stock of Vogel Popcorn. Richard Crain owned the remaining 22.51% of respondent Vogel Fertilizer's voting stock. Hence, using the figure 77.49% as the identical stock ownership of Arthur Vogel, it is clear that "5 or fewer persons" owned more than 50% of the voting stock of both corporations. Since it can hardly be disputed that "5 or fewer persons" owned at least 80% of the voting stock of both corporations —unless one adds unstated conditions to Section 1563

(a)(2)(A)—the Commissioner properly determined that respondent and Vogel Popcorn were entitled to only one surtax exemption, as originally reported on their returns.

The foregoing analysis is squarely supported by Treasury Regulations, Section 1.1563-1(a)(3) (26 C.F.R.) (App., *infra*, 3a-4a), which provides that "[t]he term 'brother-sister controlled group' means two or more corporations if the same five or fewer persons who are individuals * * * own * * * *singly or in combination*, stock possessing * * * [the requisite voting power]" (emphasis added). Indeed, the Regulations (Section 1.1563-1(a)(3)(ii)) set forth an example, which demonstrates that the 50% test may be satisfied even though each of the "5 or fewer persons" does not own stock in each corporation.

In ruling that the 80% test of subparagraph (A) is not satisfied unless each of the "5 or fewer persons" owns stock in each corporation, the Court of Claims relied, in part, upon the phrase "each such person" in subparagraph (B) and concluded that the phrase refers to the "5 or fewer persons" for purposes of both the 80% *and* 50% tests (Pet. App. 10a). Quoting with approval from the Tax Court's opinion in *Fairfax Auto Parts of Northern Virginia, Inc.* v. *Commissioner*, *supra*, 65 T.C. at 802-803, the court concluded that the statute "requires the same persons to be in the group of controlling stockholders used in both tests" (Pet. App. 10a-11a).

But the fundamental error of the Court of Claims (as well as of the Tax Court and the Fifth Circuit in *Delta Metalforming Co.* v. *Commissioner*, 632 F.2d 442 (1980), petition for cert. pending, No. 80-1499 (filed Mar. 4, 1981)) in interpreting Section

1563(a)(2) was to ignore the fact that the phrase "each such person" is found only in subparagraph (B) with respect to the 50% test. Thus, the natural reading of "each such person" is that it refers only to those persons owning more than 50% of the voting stock of each corporation, in subparagraph (B), rather than modifying the "5 or fewer persons" set forth in the prefatory part to paragraph (2).

There is consequently no justification, as a matter of grammar or logic, for singling out the phrase "each such person" in subparagraph (B) and transporting it for application in the context of subparagraph (A). Indeed, Congress would hardly have relied upon language at the end of subparagraph (B) in order to impose a requirement that the ownership group for purposes of subparagraph (A) include only those persons who own stock in each corporation.

2. The legislative history of Section 1563(a) confirms the correctness of our submission that under the plain language of Section 1563(a) the 80% test and the 50% test are independent parts of the statute. The 80% test antedated the 50% test. As originally enacted by the Revenue Act of 1964, Pub. L. No. 88-272, Section 235(a), 78 Stat. 120, Section 1563(a)(2) defined a brother-sister controlled group to be two or more corporations, if 80% of the total combined voting power or value of the shares was owned by one person. Because that rule failed to prevent the abuse of a group of corporations operated as a single economic entity claiming multiple surtax exemptions, Congress expanded the definition of a controlled group in the Tax Reform Act of 1969, Pub. L. No. 91-172, Section 401(c), 83 Stat. 602. To make the rule applicable in more situations, the stock ownership of up to five persons was to be taken

into account. However, Congress added the 50% test to assure that there would be common control of each of the corporations by some of the group.

Accordingly, the most telling point against the statutory interpretation by the decision below is that under the Court of Claims' view, respondent and Vogel Popcorn would have constituted a brother-sister controlled group if Richard Crain owned but a single share of Vogel Popcorn. Here, it is clear that Arthur Vogel—owning 77.49% of respondent's voting stock and 87.5% of Vogel Popcorn's voting stock—had the power to operate both corporations as a single economic entity. But under the majority's view, the corporations were not brother-sister and were therefore entitled to two surtax exemptions, a result that would be changed if Richard Crain owned a single share of Vogel Popcorn. Surely, Richard Crain's ownership of a single share in Vogel Popcorn would have added nothing of any economic significance. Hence, the court's gloss upon Section 1563(a) would impede the legislative purpose of denying multiple surtax exemptions to those corporations which are operated as a single economic entity. Indeed, it is difficult to imagine that Congress intended the statute to turn upon such minute distinctions which make no economic difference.

3. While we believe that the language of Section 1563(a)(2) and its legislative history support the conclusion that the 50% test is satisfied if "5 or fewer persons" own stock in each corporation either singly or in combination, the question in this case is not whether the Court of Claims has reached a more reasonable interpretation of the statute. Given the existence of a controlling Treasury Regulation and an example specifically addressed to the facts of

this case, the question is whether the Regulation is a reasonable interpretation of the statute. This Court has repeatedly ruled that as " 'contemporaneous constructions by those charged with administration of' the Code, [Treasury] Regulations" must be upheld if they are not plainly inconsistent with the statute and if they implement the statute in a reasonable way. *Commissioner* v. *South Texas Lumber Co.*, 333 U.S. 496, 501 (1948); *Bingler* v. *Johnson*, 394 U.S. 741, 749-750 (1969); *Fulman* v. *United States*, 434 U.S. 528, 533 (1978); *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472 (1979); *Commissioner* v. *Portland Cement Co.*, No. 79-1907 (Mar. 3, 1981), slip op. 12.

Here, it cannot be disputed that the controlling Treasury Regulation interprets the statutory language in a reasonable manner. Indeed, apart from the three circuits that have upheld the Regulation,[2] even the Court of Claims "admitted that the different view taken by Treas. Reg. § 1.1563-1(a)(3) is not wholly unreasonable as a construction of the words appearing in section 1563(a)(2)" (Pet. App. 12a). See also *Delta Metalforming Co.* v. *Commissioner*, *supra*, 632 F.2d at 446. And, as we have shown, that construction is consistent with the legislative history and purpose of the pertinent statutory provisions. It was, therefore, not open to the court to adopt an interpretation at variance with the Regulation even though it believed that its reading of the statute was equally or even more reasonable. In short, a court cannot set

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[2] *Fairfax Auto Parts of Northern Virginia, Inc.* v. *Commissioner*, 548 F.2d 501 (4th Cir.), cert. denied, 434 U.S. 904 (1977); *Allen Oil Co.* v. *Commissioner*, 614 F.2d 336 (2d Cir. 1980); *T. L. Hunt, Inc.* v. *Commissioner*, 562 F.2d 532 (8th Cir. 1977).

aside a reasonable Treasury Regulation in favor of another interpretation that it deems preferable. In this respect, this Court's admonition in *United States* v. *Correll*, 389 U.S. 299 (1967), is particularly appropriate. In upholding the Commissioners' overnight rule concerning the deductibility of meals consumed during business travel, the Court there stated, in terms that are equally applicable to this case (*id.* at 306-307):

> Alternatives * * * are of course available. Improvements might be imagined. But we do not sit as a committee of revision to perfect the administration of the tax laws. Congress has delegated to the Commissioner, not to the courts, the task of prescribing 'all needful rules and regulations for the enforcement' of the Internal Revenue Code. * * * The role of the judiciary in cases of this sort begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the congressional mandate in some reasonable manner.

ARGUMENT

TWO OR MORE CORPORATIONS CONSTITUTE A BROTHER-SISTER CONTROLLED GROUP UNDER SECTION 1563(a)(2)(A) OF THE INTERNAL REVENUE CODE IF FIVE OR FEWER INDIVIDUALS OWN 80 PERCENT OF THEIR STOCK SINGLY OR IN COMBINATION

A. The Governing Treasury Regulations Explicitly Provide that the Term "Brother-Sister Controlled Group" means Two Or More Corporations if the Same Five or Fewer Individuals Own the Prescribed Percentage of Stock Singly Or In Combination

Each corporation subject to the income tax is entitled to a relatively low normal rate on a prescribed initial amount of its taxable income. Beyond that amount, its

taxable income is subject to surtax rates. As a result, taxpayers have sought to increase the amount of income eligible for the lower normal rate by splitting the income of a common business enterprise among several corporations.[3] Prior to 1964, the Treasury attacked such arrangements under Sections 269, 482, and 1551 of the Internal Revenue Code of 1954. However, when the Commissioner disallowed claims to multiple surtax exemptions under those provisions, the taxpayers could show their entitlement by establishing that the securing of an additional surtax exemption was not a major purpose of the use of more than one corporation. In the Revenue Act of 1964, Pub. L. No. 88-272, Section 235(a), 78 Stat. 120, Congress sought to eliminate the need for such factual determinations by adding Sections 1561-1563 to the Code. For the first time, these provisions empowered the Commissioner to disallow a corporate surtax exemption even though the taxpayer might be able to show a non-tax reason for employing a multiple corporate structure. As we shall show, these provisions were further refined by the Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487, in a manner that gives rise to the controversy in this case.

Accordingly, Sections 1561-1563 provide an objective mathematical control test for determining

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[3] For the taxable years in issue (1973-1975), Section 11(b) of the Code imposed a normal tax of 20% of the first $25,000 of taxable income and 22% of the amount exceeding $25,000. Section 11(c) imposed a surtax of 26% of the amount by which the taxable income of a corporation exceeded the surtax exemption as provided for in Section 11(d). For the first two taxable years here in issue (the years ending November 30, 1973 and 1974), the exemption was $25,000 and, for the third year (ending November 30, 1975), was $50,000. The larger exemption for the last year is the result of a 1975 statutory amendment (Section 303(b), Act of Mar. 29, 1975, Pub. L. No. 94-12, 89 Stat. 44).

under what circumstances a group of corporations is entitled to only a single surtax exemption. Section 1561 of the Code (App., *infra*, 1a) provides that the members of a "controlled group of corporations" shall be limited to a single surtax exemption under Section 11(d). Section 1563(a)(2) (App., *infra*, 2a-3a) defines the term "controlled group of corporations" as follows:

> (a) CONTROLLED GROUP OF CORPORATIONS—For purposes of this part, the term "controlled group of corporations" means any group of—
>
> * * * * *
>
> (2) BROTHER-SISTER CONTROLLED GROUP—Two or more corporations if 5 or fewer persons who are individuals, estates, or trusts own (within the meaning of subsection (d)(2)) stock possessing—
>
> (A) at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of the stock of each corporation, and
>
> (B) more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock of each corporation, *taking into account the stock ownership of each such person only to the extent such stock ownership is identical with respect to each such corporation.* [Emphasis added.]

Under the statute, subparagraphs (A) and (B) set forth an 80% test and a 50% test. The only substantive difference between the two tests (other than the prescribed percentage) is the italicized language of subparagraph (B), which introduces a limitation not applicable to the 80% test. Thus,

the stock owned by any or all of the five persons may be taken into account in determining whether the 80% test has been met. This aspect of the statute insures that the corporations covered by the statute will be of closely-held character. On the other hand, in determining whether the 50% test has been satisfied, it is necessary to ascertain which of such persons owns stock in each of the corporations and how much each of them owns. Only to the extent that a person owns stock in each of the corporations is his stock taken into account for purposes of the 50% test. Accordingly, a person who owned no stock in one of the corporations would be excluded from consideration for purposes of that test. That is the import of the italicized language of subparagraph (B)—"taking into account the stock ownership of each such person only to the extent such stock ownership is identical with respect to each such corporation." This aspect of the statute insures commonality, *i.e.*, that the same interests will control all members of the group.

Applying the statute to the facts of the present case, Arthur Vogel owned 77.49% of the voting stock of respondent Vogel Fertilizer and 87.5% of the voting stock of Vogel Popcorn. Richard Crain owned the remaining 22.51% of respondent Vogel Fertilizer's voting stock. Hence, using the figure 77.49% as the identical stock ownership of Arthur Vogel, it is clear that "5 or fewer persons" owned more than 50% of the voting stock of both corporations within the meaning of subparagraph (B).

This much is undisputed. However, the question presented, on which the lower courts have divided, is whether "5 or fewer persons" own 80% of the stock of each corporation within the meaning of subparagraph (A) where each of them does not own stock

in each corporation. As a matter of simple textual examination of the statute, it would appear that the 80% test would be met in such circumstances. Here, two persons—Arthur Vogel (77.49%) and Richard Crain (22.51%)—owned 100% of the stock of respondent Vogel Fertilizer. Moreover, one of those persons—Arthur Vogel—owned 87.5% of the stock of Vogel Popcorn. Hence, unless one adds unstated conditions to the 80% test of Section 1563(a)(2)(A), the literal terms of the statute support the Commissioner's determination that respondent and Vogel Popcorn were entitled to only one surtax exemption, as originally reported on their returns.

2. But we do not rest our case for disallowance of respondent's multiple surtax exemptions here on a statutory construction of our own making. As we shall show in greater detail (pages 16-19, *infra*), the Commissioner's case for disallowance is squarely supported by Treasury Regulations (Section 1.1563-1(a)(3) (26 C.F.R.) (App., *infra*, 3a-4a)) that provide that "[t]he term 'brother-sister controlled group' means two or more corporations if the same five or fewer persons who are individuals * * * own * * * *singly or in combination*, stock possessing * * * [the requisite voting power]" (emphasis added). Moreover, the Regulations (Section 1.1563-1(a)(3)(ii)) set forth the following example, which specifically addresses the facts of this case and demonstrates that the 80% test may be satisfied even though each of the "5 or fewer persons" does not own stock in each corporation. The pertinent example states as follows:

"Example (1). The outstanding stock of corporations P, Q, R, S, and T, which have only one class of stock outstanding, is owned by the following unrelated individuals:

Individuals	Corporations					Identical Ownership
	P	Q	R	S	T	
A	60%	60%	60%	60%	100%	60%
B	40%	—	—	—	—	—
C	—	40%	—			
D	—	—	40%			
E	—	—	—	40%	—	
Total	100%	100%	100%	100%	100%	60%

Corporations P, Q, R, S, and T are members of a brother-sister controlled group."

If, as we submit, the Regulation is a reasonable interpretation of the statute, that is the end of the matter and the decision below ruling it invalid should be reversed. Three circuits have so upheld the validity of the Commissioner's Regulations. *Fairfax Auto Parts of Northern Virginia, Inc.* v. *Commissioner*, 548 F.2d 501 (4th Cir.), cert. denied, 434 U.S. 904 (1977); *Allen Oil Co.* v. *Commissioner*, 614 F.2d 336 (2d Cir. 1980); *T. L. Hunt, Inc.* v. *Commissioner*, 562 F.2d 532 (8th Cir. 1977). See also *Yaffe Iron & Metal Corp.* v. *United States*, 593 F.2d 832 (8th Cir. 1979). Contra: *Commissioner* v. *Delta Metalforming Co.*, 632 F.2d 442 (5th Cir. 1980), petition for cert. pending, No. 80-1499, (filed Mar. 4, 1981). Indeed, even though it held to the contrary, the Court of Claims (Pet. App. 12a) "admitted that the different view taken by Treas. Reg. § 1.1563-1(a)(3) is not wholly unreasonable as a construction of the words appearing in section 1563(a)(2)." Thus, the

question before the Court necessarily turns on the Secretary's authority to issue such Regulations interpreting the term "brother-sister controlled group" of corporations.

The existence of controlling Treasury Regulations with an example explicitly including the facts of this case within the scope of the statutory definition of "brother-sister controlled group" imposes a heavy burden on respondent who seeks to challenge the Commissioner's disallowance of its separate corporate surtax exemption on the authority of those Regulations. It must show that the Regulations are unreasonable and plainly inconsistent with the statute. In our view, it has done neither. It is fundamental that as "contemporaneous constructions by those charged with administration of" the Code, the Regulations "must be sustained unless unreasonable and plainly inconsistent with the revenue statutes" and "should not be overruled except for weighty reasons" *Commissioner* v. *South Texas Lumber Co.*, 333 U.S. 496, 501 (1948). Accordingly, "[t]he role of the judiciary in cases of this sort begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the congressional mandate in some reasonable manner." *United States* v. *Correll*, 389 U.S. 299, 307 (1967). As a unanimous Court reaffirmed only this Term in *Commissioner* v. *Portland Cement Co.*, No. 79-1907 (Mar. 3, 1981), slip op. 12, with respect to the substantial weight to be given such Regulations—

> These regulations command our respect, for Congress has delegated to the Secretary of the Treasury, not to this Court, the task "of ad-

> ministering the tax laws of the Nation." *United States* v. *Cartwright*, 411 U.S. 546, 550 (1973); accord, *United States* v. *Correll*, 389 U.S. 299, 307 (1967); see 26 U.S.C. § 7805(a). We therefore must defer to Treasury Regulations that "implement the congressional mandate in some reasonable manner." *United States* v. *Correll*, 389 U.S., at 307; accord, *National Muffler Dealers Assn.* v. *United States*, 440 U.S. 472, 476-477 (1979). To put the same principle conversely, Treasury Regulations "must be sustained unless unreasonable and plainly inconsistent with the revenue statutes." *Commissioner* v. *South Texas Lumber Co.*, 333 U.S. 496, 501 (1948); accord, *Fulman* v. *United States*, 434 U.S. 528, 533 (1978); *Bingler* v. *Johnson*, 394 U.S. 741, 749-751 (1969).

See also *Thor Power Tool Co.* v. *Commissioner*, 439 U.S. 522, 533 n.11 (1979).

We turn now to a discussion of the language and history of the statute which we believe demonstrate that the Commissioner's Regulation here falls well within his authority to interpret the statute in a reasonable manner consistent with the congressional mandate.

B. The Treasury Regulations are Consistent With the Language and Structure of Section 1563(a)(2)

1. "It is elementary that '[t]he starting point in every case involving construction of a statute is the language itself'" *Southeastern Community College* v. *Davis*, 442 U.S. 397, 405 (1979). See also *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 568 (1979). The critical words of Section 1563(a)(2)

define a "controlled group of corporations." A "brother-sister controlled group" is one of—

> (2) * * * Two or more corporations if 5 or fewer persons * * * own * * *
>
> (A) at least 80 percent of the * * * stock of each corporation, and
>
> (B) more than 50 percent of the * * * stock of each corporation, *taking into account the stock ownership of each such person only to the extent that such stock ownership is identical with respect to each such corporation.* [Emphasis added.]

The most striking characteristic of the statutory language and structure is that the conditions insuring common control in the 50% test of subparagraph (B)—the italicized portion—are exclusive to that subparagraph. They do not appear at all in the 80% test of subparagraph (A). Hence, a natural reading of the statute yields two conclusions. First, the 80% test is met if five or fewer persons own at least 80% of the stock of each corporation. Second, it is only with respect to the 50% test that the statute imposes the requirement that some of the five or fewer persons own stock in each corporation.

As we have pointed out (*supra*, page 15), it is undisputed that the overlapping control requirement of the 50% test of subparagraph (B) is met in this case because Arthur Vogel owned 77.49% of the voting stock of respondent Vogel Popcorn. Using 77.49% as the identical percentage figure, it is plain that a group of five or fewer persons (*viz.*, Arthur Vogel and Richard Crain) owned more than 50% of the stock of each corporation.

It is likewise plain that the literal terms of subparagraph (A) have been met. Arthur Vogel and Richard Crain respectively owned 77.49% and 22.51% of the stock of Vogel Fertilizer, and Arthur Vogel owned 87.5% of the stock of Vogel Popcorn. Hence, "5 or fewer persons * * * own * * * at least 80 percent of the * * * stock of each corporation" within the meaning of Section 1563(a)(2)(A).

Despite the force of the plain language of the statute, the decision below resisted the conclusion that the facts of this case meet the literal terms of Section 1563(a)(2)(A). In holding that the 80% test of subparagraph (A) is not satisfied unless each of the "5 or fewer persons" owns stock in each corporation, the Court of Claims pointed to the phrase "each such person" in subparagraph (B) and concluded that the phrase refers to the same "5 or fewer persons" for purposes of both the 80% *and* 50% tests (Pet. App. 10a). Quoting with approval from the Tax Court's opinion in *Fairfax Auto Parts of Northern Virginia, Inc.* v. *Commissioner*, 65 T.C. 798, 802-803 (1976), rev'd, 548 F.2d 501 (4th Cir.), cert. denied, 434 U.S. 904 (1977), the court concluded that the statute requires the same persons to be stockholders in both corporations.

But nothing in the language of the statute requires that the same persons own stock in both corporations. Contrary to the decision below, the phrase "each such person" does not compel, much less imply, such a conclusion. The fundamental error of the Court of Claims (as well as the Tax Court) in interpreting Section 1563(a)(2) was to ignore the fact that the phrase "each such person" is found only in subpara-

graph (B) with respect to the 50% test. Accordingly, the natural reading of "each such person" is that it refers only to those persons owning more than 50% of the voting stock of each corporation, only for purposes of subparagraph (B), and does not modify the phrase "5 or fewer persons," as that term comes into play in the application of the 80% test of subparagraph (A). As the Eighth Circuit concluded in *T.L. Hunt, Inc.* v. *Commissioner*, 562 F.2d 532, 535 (8th Cir. 1977), "[t]hus, it is apparent that Congress was aware of the language necessary to require that each person whose holdings are considered in applying the 80% test must own stock in each of the controlled corporations. We find nothing in the plain words of the statute which warrants applying such standard with respect to the § 1563(a)(2)(A) test."

There is consequently no justification, as a matter of grammar or logic, for singling out the phrase "each such person" in subparagraph (B) and transporting it for application in the context of subparagraph (A). "Such interpretation of the statute overlooks the obvious fact that those words are contained in subparagraph (B); they restrict the applicability of the 50-percent test but have absolutely nothing to do with the 80-percent test." *Fairfax Auto Parts of Northern Virginia, Inc.* v. *Commissioner, supra*, 65 T.C. at 812 (Simpson, J., dissenting, joined by Raum, Tannenwald, and Wilbur, JJ.).

Indeed, if the Court of Claims' partially amalgamated reading of subparagraphs (A) and (B) were correct, one could conclude with equal justification (contrary to even the decision below) that the entire italicized portion of subparagraph (B)—not just the

phrase "each such person"—modifies the phrase "5 or fewer persons" for purposes of applying subparagraph (A). Under such a reading of the statute, the 80% test would necessarily swallow up and displace the 50% test. The Second Circuit in *Allen Oil Co.* v. *Commissioner*, 614 F.2d 336, 339 (1980), correctly "reject[ed] the taxpayer's argument as a highly strained and convoluted reading of the statute." As the court there further observed, "[m]oreover, [that argument] proves too much. To read such a requirement into the 80% test would seriously weaken subparagraph (2)(B) and its 50% test since the 80% requirement if subjected to common ownership on the part of the group of five or fewer, would then tend to overlap or swallow the 50% identical ownership requirement."

In advancing the foregoing analysis, we do not suggest that the Court of Claims intended to transport the entire italicized portion of subparagraph (B) into subparagraph (A) and thereby obliterate the 50% test of subparagraph (B). Rather, our purpose is simply to point out that once one assumes (as did the decision below) that part of subparagraph (B) is germane for interpreting subparagraph (A), there is no convincing analysis that demonstrates which portions (if any) of subparagraph (B) are properly imported into subparagraph (A). Put another way, the statutory interpretation by the Court of Claims contains no limiting principle that makes any particular portion of subparagraph (B) any more or less appropriate for importation into subparagraph (A). In the absence of any such limiting principle, the 80% and 50% tests should therefore be regarded as separate components of the statute that are to be independently applied.

In sum, there is no justification for importing any part of subparagraph (B) into subparagraph (A), let alone the phrase "each such person", as the decision below construed the statute. As a result, there is no requirement that can be derived from the language of the statute that the same persons constitute the shareholder group for purposes of both the 80% and 50% tests. Indeed, Congress would hardly have relied upon language at the end of subparagraph (B) in order to impose a requirement that the same shareholders constitute the ownership group for purposes of subparagraph (A). If Congress sought to accomplish that result, common sense dictates that such a requirement would have been incorporated directly into the text of subparagraph (A). In this respect, the Second Circuit similarly recognized that "[a]bsent some illumination from the legislative history, we must conclude that if Congress had intended to limit the 80% test to situations where each stockholder owns shares in each member of the corporate group, it would have explicitly provided for it. Instead, it expressly required that only identically owned stock be counted for the 50% test and imposed no common ownership condition upon computation of stock ownership for the 80% test." *Allen Oil Co.* v. *Commissioner*, *supra*, 614 F.2d at 339. Accord: *T.L. Hunt, Inc.* v. *Commissioner*, *supra*, 562 F.2d at 535.

Finally, perhaps the most telling point against the statutory interpretation by the decision below is that under the Court of Claims' view, respondent and Vogel Popcorn would have constituted a brother-sister controlled group if Richard Crain owned but a single share of Vogel Popcorn. Here, it is clear that Arthur Vogel—owning 77.49% of respondent's voting stock and 87.5% of Vogel Popcorn's voting

stock—had the power to operate both corporations as a single economic entity. As we shall show (*infra*, pages 27-33), the legislative history indicates that Congress intended to disallow multiple surtax exemptions where corporations were controlled as a single economic entity. In concluding that the 80% test is not met unless each of the persons considered own some stock in each corporation, the Court of Claims has superimposed a gloss upon the statute that bears no relationship to the congressional purpose of reaching those corporations which are operated as a single economic entity.

From the standpoint of economic control, nothing of import would change in this case if Richard Crain owned a single share of Vogel Popcorn. In either instance, Arthur Vogel—with his 77.49% and 87.5% of respondent's and Vogel Popcorn's voting stock—would be no more or less able to control both corporations as a single economic entity. Although Crain's minimal ownership in Vogel Popcorn would have had no economic significance, the Court of Claims would have regarded Richard Crain's ownership of a single share of Vogel Popcorn as sufficient to disallow the multiple surtax exemptions. It is difficult to imagine that Congress intended the statute to turn upon such minute distinctions which make no economic difference.[4]

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[4] Although the Court of Claims acknowledged that Section 1563(a)(2) would apply under its interpretation if Richard Crain owned as little as one share in Vogel Popcorn, it nevertheless rejected the government's argument that Congress could not have intended to have the statute turn upon the happenstance of the ownership of a single share. As the court stated, "[i]t might well be appropriate not to consider the ownership of a token amount of stock if taxes could be

avoided by such ownership. Here the ownership of a token amount of stock would *increase* taxes, and Richard Crain would be most ill advised to acquire one share of stock in Vogel Popcorn and so cause the 80-percent test to be satisfied" (Pet. App. 33a; emphasis in original).

But the court's observation misses the critical point that its interpretation makes the statute turn on considerations that have no bearing on Congress' intent to disallow multiple surtax exemptions by corporate groups controlled as a single economic entity. The ownership by Richard Crain of one share of Vogel Popcorn would have vested him with a .00019% interest in the corporation—an amount that would neither have enhanced nor detracted from Arthur Vogel's essential economic control. Hence, the fact that Crain's ownership of a single share would have triggered, rather than foreclosed, application of the statute does not justify its interpretation that turns the application of the statute on such minute distinctions which make no economic difference. Moreover, the court's suggestion that it might have reached an alternative result if the ownership of a token share could have avoided taxes is equally ill-founded. If the shareholder group in subparagraph (A) owned one share less than 80% of the stock of one of the corporations, that would unquestionably foreclose application of the statute (see Pet. App. 28a n.14).

The Fifth Circuit's response to the single share point is similarly unconvincing. In *Delta Metalforming Co.* v. *Commissioner*, *supra*, 632 F.2d at 450, the court stated that it refused "to rewrite the numerical requirements of the statute." But our argument with respect to Crain's ownership of a single share of Vogel Popcorn does not undermine the 80% line of demarcation established by Congress. The Fifth Circuit's observation assumes the very conclusion in these cases, *viz.*, that the 80% test of subparagraph (A) requires common ownership of 80% of the stock by the same shareholders whose stock actually contributes to meeting the 50% test. In our view, the 80% test contains no such requirement. All that is necessary is that five or fewer persons own at least 80% of the stock of both corporations. Here, that requirement is met by Arthur Vogel (77.49%) and Richard Crain (22.51%).

C. The Legislative History of Section 1563 Supports the Governing Treasury Regulations

1. The legislative history of Section 1563 confirms the correctness of our submission that the statutory definition of "brother-sister group" is met if "5 or fewer persons" own the prescribed stock singly or in combination, as the governing Treasury Regulations provide.

Section 1563(a)(2) was originally enacted by the Revenue Act of 1964, Pub. L. No. 88-272, Section 235(a), 78 Stat. 116. It defined a brother-sister controlled group to be two or more corporations, if 80% of the total combined voting power, or 80% of the total combined value of the shares were owned by one person. However, the Treasury and Congress found the rule largely ineffectual because of the requirement that one person own 80% of the stock of each corporation before the group of corporations would be subject to disallowance of the multiple surtax exemptions or the imposition of a penalty. In order to make the rule applicable in a greater number of cases, the Tax Reform Act of 1969, Pub. L. No. 91-172, Section 401(c), 83 Stat. 602 expanded the number of shareholders under the 80% test from one to five, and added the 50% test to assure that there would still be common control of both of the corporations.

The general explanation of the Treasury Tax Reform Proposals contained in *Tax Reform, 1969: Hearings Before the House Comm. on Ways and Means*, 91st Cong., 1st Sess., pt. 14, 5394-5395 (1969) (hereinafter cited as "*House Hearings*"), sets forth the following reasons for the new provisions:

> *Brother-sister groups.*—A group of corporations in which five or fewer persons own, to a large extent in identical proportions, at least 80

percent of the stock of each of the corporations. This provision expands present law by considering the combined stock ownership of five individuals, rather than one individual, in applying the 80-percent test. Even the mild 6-percent penalty under existing law for brother-sister corporations claiming multiple surtax exemptions is largely ineffectual because of the percent requirement that one person own 80 percent of the stock of each corporation before the group of corporations is subject to the penalty.

However, in order to insure that this expanded definition of brother-sister controlled group applies only to those cases where the five or fewer individuals hold their 80 percent in a way which allows them to operate the corporations as one economic entity, the proposal would add an additional rule that the ownership of the five or fewer individuals must constitute more than 50 percent of the stock of each corporation considering, in this test of ownership, stock of a particular person only to the extent that it is owned identically with respect to each corporation.

Thus, even where the 80 percent ownership test is met, the brother-sister definition will not apply unless the stockholdings of the individuals in the various corporations also meet the 50-percent identical ownership test (footnote omitted).

The foregoing explanation with respect to brother-sister groups supports the interpretation adopted by the governing Treasury Regulations that the "5 or fewer persons" constituting the shareholder group for purposes of the 50% test need not own stock in each corporation for purposes of the 80% test. Indeed, the first sentence of the Treasury explanation speaks of

"[a] group of corporations in which five or fewer persons own, *to a large extent in identical proportions*, at least 80 % of the stock of each of the corporations" (*House Hearings, supra*, at 5394; emphasis added; footnote omitted). The phrase "to a large extent" suggests that there need not be common ownership among all those persons taken into account for purposes of the 80% test; rather, that whatever common ownership is required is specified by the 50% test.

Moreover, the entire second paragraph confirms the correctness of this interpretation. It makes clear that different persons may be taken into consideration in applying the 80% and the 50% tests and that the common ownership requirement applies only to the 50% test. Hence, the explanation contrasts the "five or fewer individuals [who] hold their 80 percent" with the further requirement that "the ownership of the five or fewer individuals must constitute more than 50 percent of the stock of each corporation considering, in this test of ownership, *stock of a particular person* only to the extent that it is *owned identically with respect to each corporation*" (*House Hearings, supra*, at 5394; emphasis added). The juxtaposition of the phrase referring to the stock of "a particular person" (for purposes of the 50% test) to the "five or fewer individuals" (as to which the 80% test is applied) shows that different persons may be taken into account in applying the 80% and the 50% tests, and that the common ownership requirement applies only to the 50% test.[5]

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[5] Contrary to the Court of Claims' suggestion (Pet. App. 23a), the use of the word "insure" in the second paragraph of the Treasury document quoted above ("However, in order to insure that this expanded definition of brother-sister controlled group applies only to those cases * * *") does not

Both the Court of Claims in the instant case and the Fifth Circuit in *Delta Metalforming Co.* v. *Commissioner, supra,* also addressed the Treasury's General and Technical Explanation but concluded that it undermined the Regulation because of references in another portion of the Treasury document to "the same five or fewer persons" owning at least 80% of "each corporation" and "these five or fewer individuals" owning at least 50% of the stock of each corporation (see Pet. App. 21a; 632 F.2d at 447-448).[6] But

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support the conclusion that "[t]he 80-percent test therefore must measure substantial overlapping financial interests" (Pet. App. 23a), but, indeed, supports the contrary conclusion. As the court acknowledged (*ibid.*), "[t]he 50-percent test was added to 'insure,' not to establish, the unity of economic enterprise by measuring whether overlapping control exists." Since the 80% test, standing alone, would be incapable of "insuring" overlapping control (see Pet. App. 8a n.3), the word "insure" necessarily relates only to the 50% test and not, as the court below erroneously believed, the 80% test.

[6] The portion of the Treasury's Technical Explanation upon which the decision below relied provides as follows (*House Hearings, supra,* at 5168-5169; emphasis added):

> *Brother-sister controlled group.* Present law defines a brother-sister controlled group as a group of corporations in which the voting stock or value of shares of each member is owned 80 percent by the same person (*i.e.*, individual, estate or trust). *Under the proposal, the present definition would be changed so that a group of corporations would constitute a brother-sister controlled group if (1) the same five or fewer persons own at least 80 percent of the voting stock or value of shares of each corporation,* and (2) *these* five or fewer individuals own more than 50 percent of the voting power or value of shares of *each* corporation considering a particular person's stock only to the extent that it is owned identically

these references simply underscore the fact that the same group of five or fewer persons, rather than a different group, is to be considered in applying both the 80% and 50% tests. Contrary to the decision below, these references in the Treasury's Technical Explanation do not establish that each person whose stock is considered for purposes of the two tests must own stock in each corporation of the group.

2. Moreover, when Congress decided in 1969 to expand the coverage of Section 1563, it used exactly the same words as Section 1551(b)(2) to describe a brother-sister controlled group of corporations.

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with respect to each corporation. This definition is the same as that under section 1551 (relating to the disallowance of surtax exemptions and accumulated earning credits in cases of transfers in order to secure the exemption or credit).

Part (1) of this test is satisfied if the group of five or fewer persons as a whole owns at least 80 percent of the voting stock or a value of shares of each corporation, regardless of the size of the individual holdings of each person. Thus, for example, part (1) (but not necessarily part (2)) is met whether one person owns 80 percent of the voting stock of each corporation, four persons each own 20 percent of the voting stock of each corporation, or one person owns 60 percent of the voting stock of one corporation and 40 percent of another, and another person owns 40 percent of the voting stock of the first and 60 percent of the second.

Part (2) of the test is satisfied only if the same five or fewer persons own more than 50 percent of the voting stock or value of shares of each corporation, considering stock owned by a particular person only to the extent that it is owned identically in each of the corporations. Thus, for example, a person who owns 80 percent of the voting stock of one corporation and 30 percent of another would be considered as owning 30 percent of both corporations for purposes of part (2) of the test.

Thus, in expanding the 80% test to include as many as five shareholders and adding the overlapping control criteria of the 50% test, the pertinent House Committee on Ways and Means Report stated that "[t]he stock ownership test [for brother-sister controlled groups] would be the same test employed in Section 1551(b)(2) * * *." H.R. Rep. No. 91-413, (Pt. 2), 91st Cong., 1st Sess. 76 (1969). The Committee's statement is in accord with the Treasury's Technical Explanation that "[t]his definition is the same as that under Section 1551" (*House Hearings, supra*, at 5168). At that time, Treasury Regulations, Section 1.1551-1(g)(4) included an example (Example 4) indicating that the ownership of a person could be taken into account for purposes of the 80% test although he did not own stock in each of the corporations and was therefore not considered for purposes of the 50% test. Since the Treasury officials who drafted the 1969 amendments to Section 1563 were doubtless familiar with the Regulations under Section 1551, it is not unreasonable to assume that Congress intended that the same definitional terms in the two statutes should have the same meaning.

Although the Court of Claims (Pet. App. 25a-27a) and the Fifth Circuit in *Delta Metalforming Co.* v. *Commissioner, supra*, 632 F.2d at 450-451, acknowledged the similarity between Section 1563(a)(2) and 1551, they both rejected the inference that Congress intended to adopt the interpretation of the Section 1551 Regulations. In the Court of Claims' view, the examples under Section 1.1551-1(g)(4), of the Regulations "may indicate a contrary proposition" and "are intended as illustrations of the nature of the transfer required under that paragraph rather than as illus-

trations of the meaning and application of the term 'control' * * *" (Pet. App. 27a). But the plain fact is that Example (4) under Section 1.1551-1(g)(4) of the Regulation does show that under the identical statutory language, ownership of stock in both corporations is not a requirement under the 80% test. That the example may also demonstrate another proposition does not undermine the force of our argument that Congress intended Section 1551 and 1563 to be interpreted identically.

Contrary to the Fifth Circuit's observation in *Delta Metalforming Co.* v. *Commissioner*, *supra*, 632 F.2d at 450-451, the facts that Section 1551 requires a transfer and that the Section 1551 Regulations do not use the precise language of the Section 1563 Regulations—"singly or in combination"—does not render Section 1551 irrelevant. Given the identical language of the two statutes and the undisputed fact that an inference can be drawn from the Section 1551 Regulations that supports the validity of the Section 1563 Regulations, "it is immaterial that section 1551 applies when there is a transfer of property and that section 1563 applies without a showing of a transfer of property" *Fairfax Auto Parts of Northern Virginia, Inc.* v. *Commissioner*, *supra*, 65 T.C. at 810 (Simpson, J., dissenting).[7]

[7] A similar inference can be drawn from Section 1015 of the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. No. 93-406, 88 Stat. 925, which added Section 414 to the Internal Revenue Code. Subsections (b) and (c) of that provision incorporate the control test of Section 1563(a). Since the Regulations under Section 1563 at issue were issued three years prior to the enactment of ERISA and no court had held them invalid at that time, it is reasonable to assume that Congress approved the Commissioner's construction that the same shareholders were not

3. a. Despite the support for the governing Treasury Regulations in the above-described legislative history, the decision below and the Fifth Circuit in *Delta Metalforming Co.* v. *Commissioner, supra,* concluded that the 1969 amendment to Section 1563(a) sought to apply the principle of common ownership to the 80% test as well as the 50% test. As those decisions view the matter, the 80% financial interest tests would be rendered meaningless unless the same group of five or fewer shareholders own 80% of each corporation. (See Pet. App. 22a; *Delta Metalforming Co.* v. *Commis-*

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required to own stock in each corporation for purposes of the 80% test. See *Helvering* v. *Winmill,* 305 U.S. 79, 83 (1938); *United States* v. *Correll, supra,* 389 U.S. at 305-306.

Moreover, while the failure of Congress to enact legislation is not dispositive, it is nevertheless significant that in 1974, the American Bar Association's Tax Section proposed an amendment to Section 1563(a) which would have vitiated the Treasury Regulations at issue in this case by incorporating the ownership requirements proposed by respondent and the decision below and the Fifth Circuit. Under the proposed amendment (Tax Section Recommendation No. 1974-1 (A.B.A.), 27 Tax Lawyer 813, 817 (1974)) Section 1563 (a)(2) would have read:

> (2) *Brother-sister controlled group.* Two or more corporations if *each of the same* 5 or fewer persons who are individuals, estates, or trusts own (within the meaning of subsection (d)(2)) stock *in each corporation, such stock in the aggregate* possessing—
>
> > (A) at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of the stock of each *such* corporation * * *. [Emphasis in original.]

Congress, however, has not adopted this, or indeed, any other change in the statute.

sioner, *supra*, 632 F.2d at 450; *T.L. Hunt, Inc.* v. *Commissioner*, *supra*, 562 F.2d at 537 (Webster, J., dissenting)).

We submit that the 80% test continues to have independent significance under the statutory interpretation of the Treasury Regulations. It insures that all the members of the corporate group will be closely held thereby facilitating their operation as a single economic enterprise. To be sure, part of this goal is achieved by the overlapping control requirement imposed by the 50% test. But the 80% test also insures that the more-than-50-percent shareholder control group can obtain additional control in those instances where a greater interest is needed without the necessity of dealing with a large number of other shareholders (see Pet. App. 40a, Smith, J., dissenting). Thus, contrary to Judge Webster's dissenting opinion in *T.L. Hunt, Inc.* v. *Commissioner*, *supra*, 562 F.2d at 537, it is *both* the smallness of the number of persons in each corporation as well as the sameness of some of those persons that is significant. As the Second Circuit put it in *Allen Oil Co.* v. *Commissioner*, *supra*, 614 F.2d at 340, "the 80% test is designed to assure that within the group of five persons or fewer the overall control of or financial interest in each of the corporations will beyond question be substantially more than 50% (*i.e.*, 80%), whereas the 50% test is intended to assure that there will be a minimum commonality or community of interest between members of the five or fewer persons in control; otherwise there might be no tie between persons controlling one corporation and those controlling another."

b. Nor is there any convincing basis for the view expressed below that "[w]hen Congress in 1969 expanded the definition of brother-sister controlled corp-

orations to cover situations where up to five people owned 80 percent of the stock, it is reasonable to assume that it intended to build on the previous law, changing only the number of persons whose stock interests would be considered and not the nature of those interests" (Pet. App. 35a; Friedman, Ch. J., concurring). To be sure, in the pre-1969 version of the statute, the stock of only one person could be taken into account. That single person had to own 80% of the stock of each corporation to trigger the statute. Hence, 80% of identical, or overlapping, ownership was necessarily present in a controlled group. But once the number of shareholders was increased to five and the 50% test of subparagraph (B) was added to the statute, the required overlap was necessarily reduced from 80% to 50%. The statute as presently drawn cannot be construed to contain an 80% overlapping identical control requirement.

Indeed, the Court of Claims' own construction, which would have reached the opposite conclusion had Richard Crain owned a single share of Vogel Popcorn, does not require the existence of the 80% overlapping control requirement that it asserts Congress intended to preserve by the 1969 amendment. Consider the following example: Corporations X and Y have the following shareholders with the following percentages of stock:

	X	Y
A	51%	51%
B	2%	9%
C	2%	40%
D	25%	—
E	20%	—
Total	100%	100%

Under the Treasury Regulation, both the 80% and the 50% tests are met; under the decision below the 80% test is not satisfied. But if shareholder C transfers only one share of Y corporation to D, the Court of Claims would consider the 80% test met because the same four shareholders (A, B, C, and D) would contribute to each test, even though there is only the same 55% overlapping control as before the transfer. Put another way, once the 50% overlapping identical control test was introduced in subparagraph (B), the 80% requirement of the previous statute was necessarily eliminated. Hence, apart from the fact that there is no legislative history to support the hypothesis that Congress intended to "build on the previous law," it is also demonstrably erroneous.

In sum, the plain language of Section 1563(a) and its legislative history support the governing Treasury Regulations as a reasonable and contemporaneous interpretation of the statute that is consistent with Congress' intent to disallow multiple surtax exemptions of those corporate groups operated as a single economic entity. The requirement by the decision below that Richard Crain had to own at least a single share of Vogel Popcorn for the statute to apply makes no sense, as a matter of logic, or economics. Although the Court of Claims' alternative interpretation may be thought to serve plausible policy goals, respondent "needs more than a plausible policy argument to prevail here" (*National Muffler Dealers Ass'n* v. *United States*, *supra*, 440 U.S. at 488) in the face of the Commissioner's Regulation. "The choice among reasonable interpretations is for the Commissioner, not the courts" (*ibid.*). Hence, the posture of this case is

analogous to that of *National Muffler Dealers Ass'n*, where the Court stated, in terms that equally support our submission here (440 U.S. at 484):

> In short, while the Commissioner's reading of § 501(c)(6) perhaps is not the only possible one, it does bear a fair relationship to the language of the statute, it reflects the views of those who sought its enactment, and it matches the purpose they articulated. It evolved as the Commissioner administered the statute and attempted to give to a new phrase a content that would reflect congressional design. * * * *The Commissioner's view therefore merits serious deference.* [Emphasis added.]

CONCLUSION

For the reasons stated, the judgment of the Court of Claims should be reversed.

Respectfully submitted.

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APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SECTION 11 [as amended by Revenue Act of 1964, Pub. L. No. 88-272, Section 121, 78 Stat. 25, and Tax Reform Act of 1969, Pub. L. No. 91-172, Section 401(b)(2)(B), 83 Stat. 602]. TAX IMPOSED.

* * * * *

(d) *Surtax Exemption*—For purposes of this subtitle, the surtax exemption for any taxable year is * * *, except that, with respect to a corporation to which section 1561 or 1564 (relating to surtax exemptions in case of certain controlled corporations) applies for the taxable year, the surtax exemption for the taxable year is the amount determined under such section.

* * * * *

SECTION 1561 [as added by Revenue Act of 1964, Pub. L. No. 88-272, Section 235(a), 78 Stat. 116, and amended by Tax Reform Act of 1969, Pub. L. No. 91-172, Section 401(a)(1), 83 Stat. 599]. LIMITATIONS ON CERTAIN MULTIPLE TAX BENEFITS IN THE CASE OF CERTAIN CONTROLLED CORPORATIONS.

(a) *General Rule.*—The component members of a controlled group of corporations on a December 31 shall, for their taxable years which include such December 31, be limited for purposes of this subtitle to—

(1) one * * * surtax exemption under section 11(d),

(2) one $100,000 amount for purposes of computing the accumulated earnings credit under section 535(c)(2) and (3), and

(3) one $25,000 amount for purposes of computing the limitation on the small business deduction of life insurance companies under sections 804(a)(4) and 809(d)(10).

The amount specified in paragraph (1) shall be divided equally among the component members of such group on such December 31 unless all of such component members consent (at such time and in such manner as the Secretary or his delegate shall by regulations prescribe) to an apportionment plan providing for an unequal allocation of such amount. The amounts specified in paragraphs (2) and (3) shall be divided equally among the component members of such group on such December 31 unless the Secretary or his delegate prescribes regulations permitting an unequal allocation of such amounts.

* * * * *

SECTION 1563 [as added by Revenue Act of 1964, Pub. L. No. 88-272, Section 235(a), 78 Stat. 120, and amended by Tax Reform Act of 1969, Pub. L. No. 91-172, Section 401(c), 83 Stat. 602]. DEFINITIONS AND SPECIAL RULES.

(a) *Controlled Group of Corporations.*—For purposes of this part, the term "controlled group of corporations" means any group of—

* * * * *

(2) *Brother-Sister-Controlled Group.*—Two or more corporations if 5 or fewer per-

sons who are individuals, estates, or trusts own (within the meaning of subsection (d)(2)) stock possessing—

(A) at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of the stock of each corporation, and

(B) more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock of each corporation, taking into account the stock ownership of each such person only to the extent such stock ownership is identical with respect to each such corporation.

* * * * *

Treasury Regulations on Income Tax (26 C.F.R.):

§ 1.1563-1 *Definition of controlled group of corporations and component members.*

(a) *Controlled group of corporations.*—(1) *In general.* For purposes of sections 1561 through 1563 and the regulations thereunder, the term "controlled group of corporations" means any group of corporations which is either a "parent-subsidiary controlled group" (as defined in subparagraph (2) of this paragraph), a "brother-sister controlled group" (as defined in subparagraph 3 of this paragraph, a "combined group" (as defined in subparagraph (4) of this para-

graph), or an "insurance group" (as defined in subparagraph (5) of this paragraph). For the exclusion of certain stock for purposes of applying the definitions contained in this paragraph, see section 1563(c) and § 1.1563-2.

* * * * *

(3) *Brother-sister controlled group.* (i) The term "brother-sister controlled group" means two or more corporations if the same five or fewer persons who are individuals, estates, or trusts own (directly and with the application of the rules contained in paragraph (b) of § 1.1563-3) singly or in combination, stock processing—

* * * * *

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